

## Small is still beautiful

01 August 2006

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This report is part of a twice-yearly series that analyses emerging trends in the Australian market for new motor vehicles. The last issue was released in February 2006. We regularly publish separate reports on retail sales (March and September) and Australian consumer trends (quarterly).

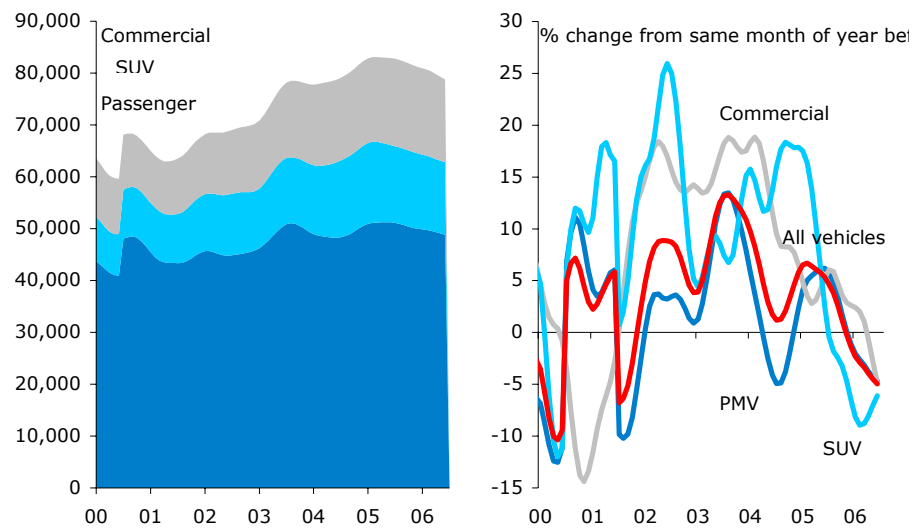
### Recent sales trends

In early 2006, new vehicle sales were appearing to recover from the petrol price hikes of late 2005. Total sales were looking likely to grow to one million by year end. However, further increases in petrol prices (with no reduction in sight) plus an interest rate rise in May meant sales continued to fall, rather than recover and grow, in H1 2006. In annual growth terms, sports utility (SUV) sales have now been falling since July 2005 and passenger (PMV) sales have been falling since December 2005. Commercial vehicle sales remained buoyant through the first quarter of 2006, but turned negative in April 2006 (see figure 1).

In total, 17,000 fewer vehicles were sold in H1 2006 than in H1 2005 — 3.4% lower than the all-time record of 500,000. Most of this sales drop was due to fewer private buyers of large, Australian-made passenger cars. Large cars (the single biggest vehicle category) declined by a massive 19,217 sales (22%) in H1 2006 compared with H1 2005. SUVs of all sizes were similarly affected, with almost 7,000 fewer SUV sales in H1 2006.

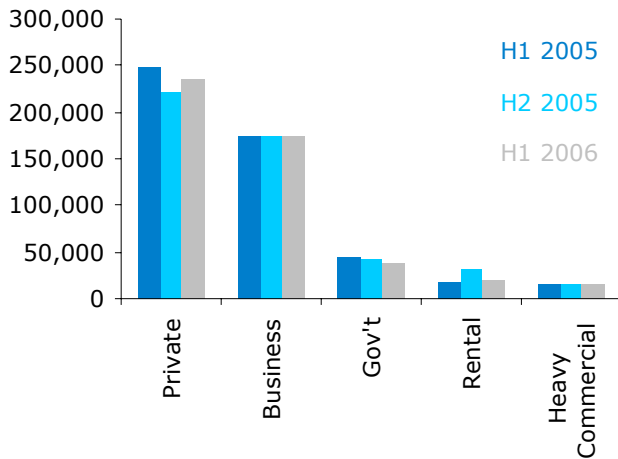
While total sales numbers are down from the record peaks of 2005, they remain historically high, and the outlook for the second half of 2006 is brighter. Significant income tax cuts from 1 July combined with a positive prognosis for employment and wages growth should lead to greater demand from private buyers. Long-awaited new model releases by local manufacturers might also help tempt back customers. On the other hand, further interest rate rises and no end in sight to historically high petrol prices will dampen demand from households and businesses alike.

**Figure 1: New vehicles sales per month (trend)**



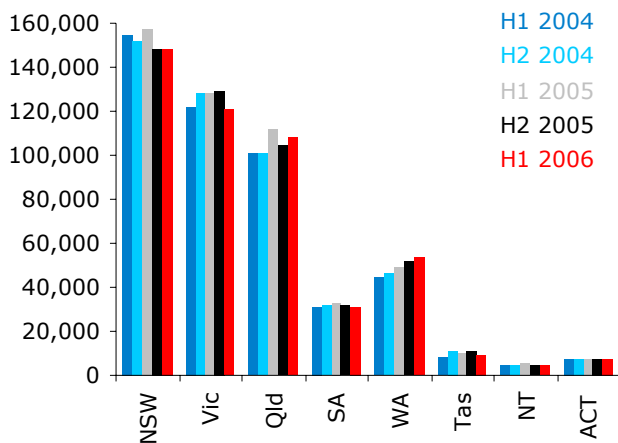
Source: ABS 9314.0

Figure 2: New vehicle sales by buyer type



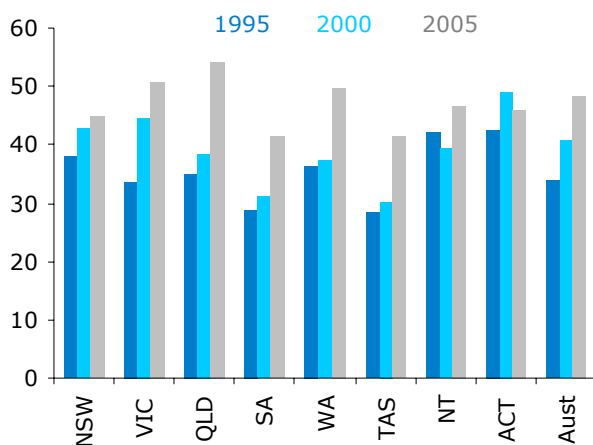
Source: VFACTS

Figure 3: New vehicle sales by state



Source: ABS 9314.0

Figure 4: New vehicle sales per 1,000 people



Source: ABS 9314.0; ; Economics@ANZ

## Who is buying new vehicles?

The first half of 2006 saw 13,500 fewer sales (5.4%) to private buyers and 5,000 fewer sales to governments than in the same period of 2005. Sales to business and rental buyers both increased slightly (see figure 2). Finance commitments for vehicles tells a similar story. In the five months to May 2006, personal finance commitments for new cars were down 4.9% on the same period of 2005, and personal finance for all vehicles (including new cars, used cars, motorcycles and other vehicles) were down 5.1%. In contrast, commercial finance commitments for all vehicles (new and used) was up 8.2% and lease finance was up 0.7% over the same period.<sup>1</sup>

This pattern of falling private but stable business sales is consistent with the broad shift we have seen in economic momentum from households to businesses in 2006. In addition, private buyers (and especially car-dependent commuters and/or holders of large mortgages) are likely to have been more sensitive than businesses to the key factors that affected the vehicle market in H1 2006, including further petrol price rises, the May interest rate rise the much-publicised release dates for new Australian passenger cars.

Geographically, automotive sales were down in all states and territories in H1 2006 relative to H1 2005, except WA, where auto sales increased by 9.7% (see figure 3 and appendix). Western Australia is currently benefiting from booming commodity prices, a strong property market and record low unemployment. This unique economic strength is reflected in the state's vehicle sales.

Nationally, the number of new vehicles purchased per capita has risen significantly over the last decade, from 34 new vehicles per 1,000 people per year in 1995 to 48 in 2005. This pattern has contributed to an increase in the stock of registered vehicles on Australian roads and a decrease in the average age of most types of vehicle<sup>2</sup>. This long-term trend may have temporarily halted or reversed in 2005-06, as fewer private buyers chose to replace their cars.

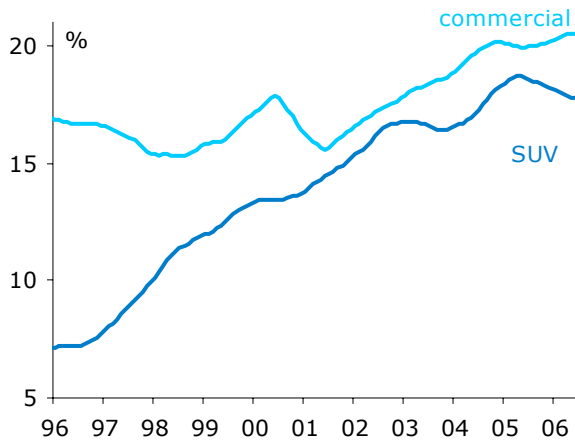
New vehicle sales per capita vary across states and territories due to differences in geography, demographics, lifestyles and industries. In 2005, the number of new vehicles purchased per 1,000 people per year ranged from 54 in Qld to 41 in SA. Over the last decade, the increase in new vehicles per person has been strongest in Qld and WA — the states with the strongest economic and population growth in recent years, but not necessarily the highest incomes per capita<sup>3</sup> — and weakest in NSW and the ACT (see figure 4).

<sup>1</sup> ABS 5671.0.

<sup>2</sup> Economics@ANZ, *Motor Vehicle Outlook*, Feb 2006.

<sup>3</sup> Economics@ANZ, *State and Territories Economic Update*, July 2006.

Figure 5: Market share by type of vehicle



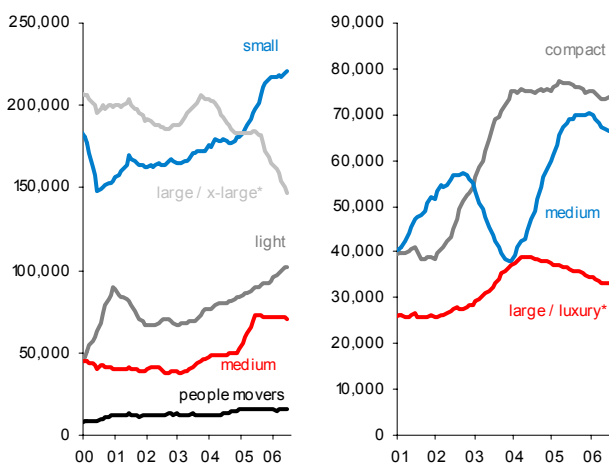
12 month moving average, trend.  
Source: ABS 9314.0

Figure 6: Australia's favourite marques

Top 8, 2006 % share	2000	2005	H1 2006 (YTD)
1. Toyota	19.9	20.5	21.7
2. Holden	19.0	17.7	15.4
3. Ford	14.5	13.1	12.5
4. Mazda	3.5	6.7	6.7
5. Mitsubishi	9.3	6.3	5.8
6. Nissan	5.8	5.7	5.5
7. Honda	3.8	4.8	5.4
8. Hyundai	5.8	4.9	5.2
<b>Total sales</b>	<b>787,100</b>	<b>988,269</b>	<b>483,160</b>

Source: ABS; VFACTS.

Figure 7: annual passenger car and SUV sales



12 month rolling sum. \* large PMVs plus 'upper large' from Nov 2004, large SUVs plus 'luxury' from Jan 2003.  
Source: VFACTS.

## What are we buying?

Over the last decade, Australia's vehicle choices have become more diverse. A decade ago, over 75% of new vehicle sales were passenger cars, including 30% of sales going to large passenger cars. Their share had dropped to 61% by 2005-06 (including 15% of sales going to large or upper large passenger cars), in favour of commercial vehicles and SUVs (although SUVs' share has dropped again since early 2005; see figure 5). Reflecting the current strength of business activity in many — but by no means all — Australian locations and industries, commercial vehicles are currently taking a record share of the market, with 20.5% of total sales in H1 2006.

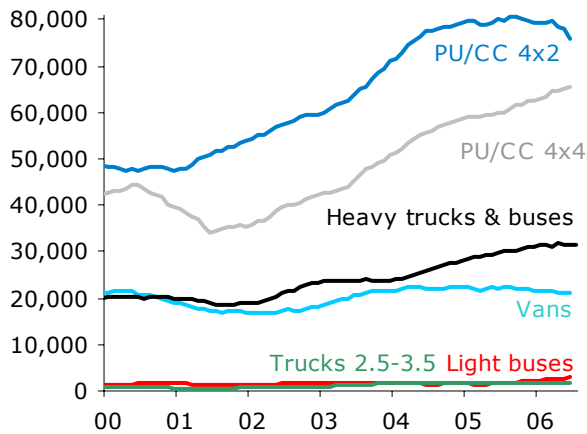
Strong competition and growing imports have seen a wider range of marques and models available in Australia. The market is however, still dominated by a handful of marques, with the top three still accounting for about half of all new sales. Australia's four local vehicle manufacturers retain four of the top five slots, despite losing market share in recent years (see figure 6).

## New passenger cars and SUVs

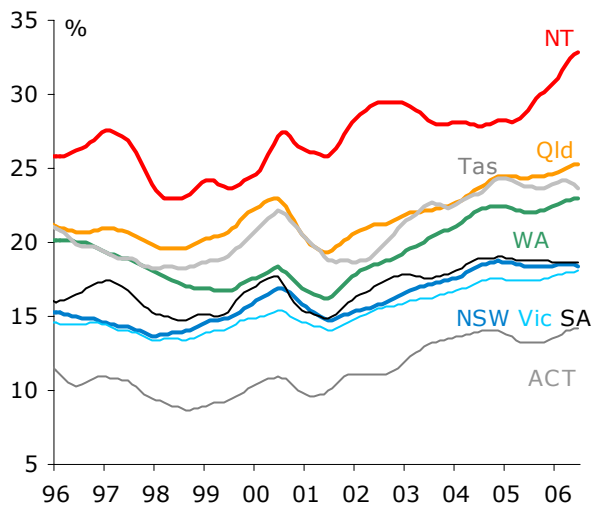
The trend in favour of smaller PMV and SUV models that commenced about two years ago has, if anything, accelerated in 2006. Sales of large PMVs and large SUVs plummeted dramatically — down 22% and 24% in H1 2006, compared with H1 2005. In a clear reaction to high petrol prices, some of the 'lost' large car sales were replaced with smaller vehicles. Light passenger cars were especially popular in H1 2006, with sales up by 9,300 cars (19.6%) from H1 2005 (see figure 8). This trend can be expected to continue since the key influence — high petrol prices — is not going to abate, and may even push higher. The low prices of small and light cars (with many priced under \$20k) will also help to attract buyers.

Other large car purchases appear to have been postponed or possibly cancelled altogether, as higher petrol and interest rates and other cost pressures eat into household budgets. Naturally, the industry hopes private buyers have only postponed, and cites the pending release of new large car models as a likely explanation.

Further evidence of the effect of petrol prices on car buyers' purchasing decisions can be found in the small but significant shift toward non-petrol cars and SUVs in 2005-06. While the majority of new PMVs and SUVs are still petrol, the share of sales going to alternative fuels (hybrid, diesel and LPG) has increased from 2.1% of PMVs and 17.3% of SUVs in H1 2005, to 5.3% of PMVs and 20.6% of SUVs in H1 2006. These figures underestimate the proportion of LPG cars on the road, since most are converted after initial sale.

**Figure 8: annual commercial vehicle sales**

12 month rolling sum.  
Source: VFACTS

**Figure 9: Commercial vehicles' share of sales**

12 month moving average, trend.  
Source: ABS 9314.0

**Figure 10: Australian auto production & sales**

	Total Aust. production	Aust. sales & market share
1980	364,033	365,334 (66%)
1990	381,780	361,494 (61%)
2000	355,500	247,187 (32%)
2003	413,000	297,167 (31%)
2004	414,500	274,539 (29%)
2005	395,000	248,913 (25%)
<b>H1 2006 (YTD)</b>	<b>156,190</b>	<b>100,570 (20%)</b>
<i>FAPM forecasts*</i>		
2006	338,540	212,901 (24%)
2007	371,302	213,642 (24%)
2008	378,070	214,070 (24%)

\* Forecast by FAPM, March 2006.  
Sources: AAI; FCAI; FAPM.

## New commercial vehicles

Commercial vehicle sales do not appear to have been affected by petrol price increases to the same degree as passenger cars. Sales in H1 2006 were almost level with the record set in H1 2005 (down just 507 vehicles, or 0.5%).

While small is beautiful for PMVs and SUVs, it is not for commercial vehicles. In H1 2006, sales of heavy trucks were up slightly (by 2.1%) and light commercial vehicles down slightly (by 0.9%) on H1 2005. Within the 'light commercial' category, the most popular vehicles are 4x2 and 4x4 PU/CCs. Sales of 4x4s grew by 8.6% in H1 2006 (from H1 2005), while sales of 4x2s fell by a similar proportion. Depending on the business application, fewer large vehicles can be more efficient than a greater number of small vehicles.

Heavy truck sales are benefiting from growing demand for national road freight transport, despite rising fuel prices and other cost pressures (particularly for small operators). Australia's truck fleet growth has accelerated in recent years, from 20,000 new medium to heavy truck registrations in 2002, to 31,000 in 2005. The industry expects new registrations to reach 35,000 by the end of 2006 and over 55,000 by 2010.<sup>4</sup>

As noted above, commercial vehicles have been growing as a share of the total vehicle market and are currently taking a record high of 20% of all vehicle sales. Commercial vehicles' share of sales is highest in the large mining and agricultural states of NT (33%), Qld (25%), Tas (24%) and WA (23%) and lower in the more urban economies of the southeast and especially the ACT (14%) (2005-06, trend). These relative shares reflect different industry mixes and geographic landscapes and have been reasonably constant over the past decade (see figure 9).

## Australian-made vehicles

Australian-made vehicles continued their long-term loss of market share in 2005-06 (down to 20.1%). H1 2006 also saw a large fall in absolute sales numbers, with 27,000 fewer sales than in same period of 2005. By contrast, 10,000 more imported vehicles were sold. This may be partly due to this year's release schedule for new models (as many in the industry claim), but it is also due to a clear preference among a growing number of car buyers for smaller — usually imported — models. Given this change in the market, Mitsubishi's new large car, the 380, did not do much to improve its local sales share upon its release in February. The forthcoming VE Commodore from Holden and new Camry models from Toyota later in 2006 are likely to lift those marques' sales, but it remains to be seen whether they will be enough to reclaim the market.

<sup>4</sup> Snapdata, *Australia trucks 2006*, May 2006.

## Outlook for 2006 and 2007

Australia's economy is currently running hot — almost too hot. Capacity constraints are being felt in the labour market, in commercial property and in infrastructure construction (with especially tight pressures in the mining boom areas of WA). Business is borrowing and investing heavily in buildings, plant and equipment, including in vehicles. Inflation and interest rates are however, on an upward path, and the global commodities price boom looks to be peaking, all of which will slow business investment momentum by 2007.

In the household sector, employment and incomes growth will remain healthy, but the residential property market and consumer spending are still relatively flat in many locations (and especially in NSW). High petrol prices, rising interest rates and other price rises have reduced household spending power, but spending will pick up in H2 2006, as the effects of July's tax cuts start to flow through. All of these factors will affect householders' demand for new cars. Consumers are learning to adjust to the new pricing environment — few now expect petrol prices to fall below \$1 per litre again. Concerns about fuel prices, inflation and interest rates will remain foremost in private buyers' vehicle purchasing decisions through 2006-07.

**Figure 11: Key economic forecasts, Australia**

Annual growth %	2006(f)	2007(f)
<b>ECONOMY</b>		
Gross Domestic Product	3.1	3.1
Gross National Expenditure	3.9	3.0
Official interest rate (%)	6.00	6.25
Credit (total)	14.2	12.5
Private consumption	3.2	3.0
- dwelling investment	-4.3	1.5
- non-dwelling investment	8.4	2.6
- equipment investment	14.6	1.9
Business investment (total)	11.3	2.5
<b>LABOUR &amp; PRICES</b>		
Employment	1.7	1.8
Unemployment rate (%)	5.0	5.0
Av. weekly ord. time earnings	3.9	5.1
Consumer Price Index	3.1	2.6
<b>TRADE</b>		
Terms of trade	4.0	-2.9
Au\$/US\$ (rate, Dec.)	0.72	0.68
Au\$ TWI (index, Dec.)	58.90	54.52

Source: Economics@ANZ (as at 1 August 2006).

## New vehicle sales outlook

Where to from here for Australia's vehicle market? One industry view is that private buyers have been delaying their car purchases rather than reducing them *per se*, and that sales will surge as new models are released in 2006. Others are less optimistic. Current industry forecasts include:

- Australian Automotive Intelligence expects 977,250 new vehicle sales in 2006 (1.1% less than 2005), rising to 982,750 in 2007 and 983,250 in 2008 (April 2006).
- The FCAI is forecasting 980,000 sales for 2006, 8,000 (or less than 1%) fewer than the record sales of 2005 (June 2006).
- The FAPM is more pessimistic. It expects new vehicle sales of just under 870,000 in 2006, rising to 887,119 in 2007 and 901,727 in 2008 — still well below the 988,000 sales achieved in 2005. The FAPM assumes Australian-made cars will keep 24% of the market (March, 2006).

In February, we estimated that 2006 sales would be about 3% higher than in 2005. We have since revised our estimate down to zero growth for 2006, mainly due to the negative impact of repeated petrol price and interest rate increases. Although sales for the year to date have been 3.4% lower than 2005, we believe total sales will pick up enough in the second half of the year to bring the annual figure close to the 988,000 new vehicles sold in 2005. Zero annual growth would require sales of around 505,000 vehicles in H2 2006 — that is, 16,900 (or 3.4%) more sales than in H2 2005. Given that 2005 was a record year for new vehicle sales, a similar level of sales for 2006 would be an excellent outcome for the industry.

Factors that will boost sales in H2 2006:

- continuing growth in household incomes, employment and business investment
- income tax cuts from July 2006
- release of new models of popular Australian-made cars, including Toyota's Camry and Holden's VE Commodore (see figure 12).

Factors that will detract from sales in H2 2006:

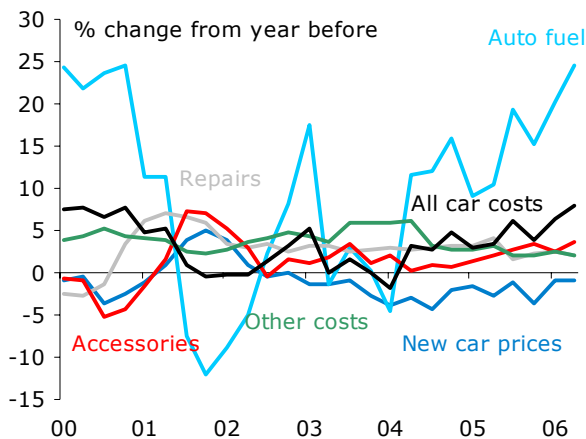
- increase in official interest rates in August (with another rate rise likely sometime later)
- continuing high petrol prices, plus widespread expectations of further fuel price increases, which are changing the dynamics of Australia's automotive market, in terms of both the number and type of new cars that consumers are willing to purchase.
- Price inflation for essential goods and services (including health, education, housing and some foods), which will reduce household funds that might otherwise have paid for a new car, or serviced a loan on a new car.

Figure 12: Forthcoming new passenger models

Estimated date	Model
July 2006	Alfa Romeo 159 <b>Toyota Camry</b>
August 2006	Alfa Romeo Brera BMW Z4 Coupe Dodge Caliber <b>Holden VE Commodore</b> Volkswagen Golf R32; Toureg V6
September 2006	Citroen C1; Mini five door
March 2007	Fiat Panda; Volvo S40 R Volkswagen Eos convertible
June 2007	Volkswagen Phaeton
July 2007	Alfa Romeo 159 Sportswagon
September 2007	BMW M3 <b>Holden VE Ute</b>
October 2007	Alfa Romeo 169 and 149 Audi Le Mans quattro
March 2008	<b>Ford Falcon</b>

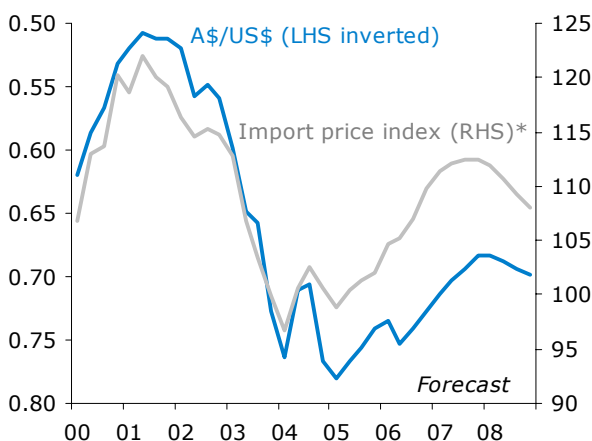
Sources: FAPM; Holden; GoAuto New Car Diary.

Figure 13: Private motor vehicle prices



Source: ABS 6401.0.

Figure 14: Exchange rate and import prices



\* Composition-adjusted import price deflator.  
Source: ABS 5206.0; Datastream; Economics@ANZ.

Looking forward to 2007, Australian economic growth can be expected to decelerate somewhat, if only because we are already growing at close to full potential; the only direction from here is a slowdown (but not yet a cessation) in growth. Business investment is already showing signs of slowing, and further interest rate rises in 2006-07 (made necessary by rising inflation) will dampen it further. Real income and employment growth are expected to keep household wealth, debt and consumption trending up, although consumer spending will decelerate as interest rates rise.

In this slower-paced (but in no way recessionary) environment — and without significant new model releases or population growth to stimulate private car sales — it is difficult to see where further sales growth might come from in 2007. Therefore, we expect annual sales to continue to hover at or just below 1 million vehicles, with growth of no more than 2% in 2007.

Figure 15: Expected new vehicle sales, annual

	2006(f)	2007(f)
Number of sales ('000)	980-990	990-1,100
Annual % growth	-0.5 — 1%	0 — 2%

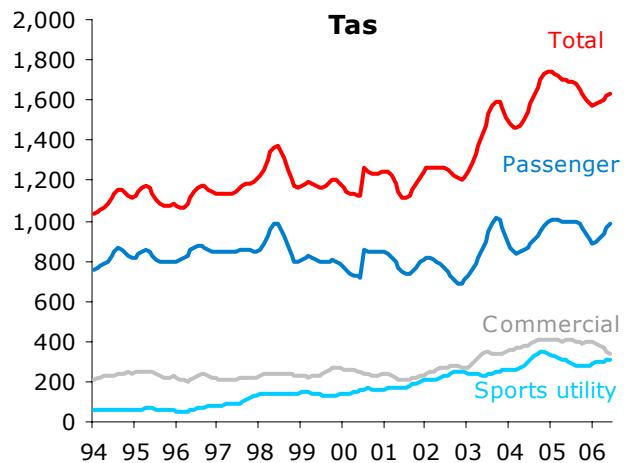
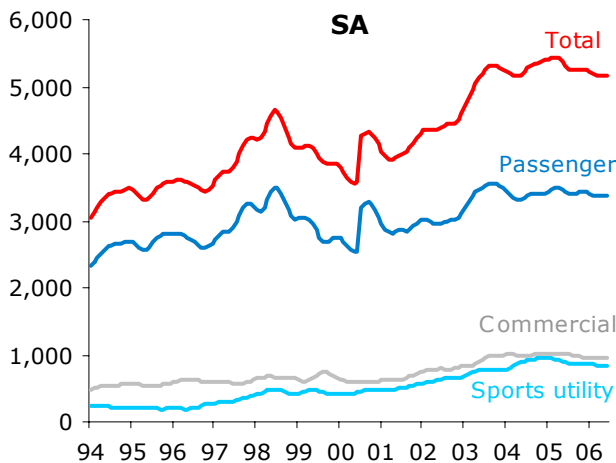
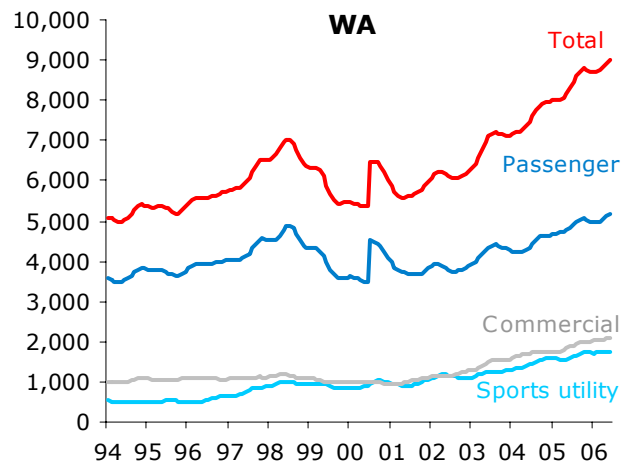
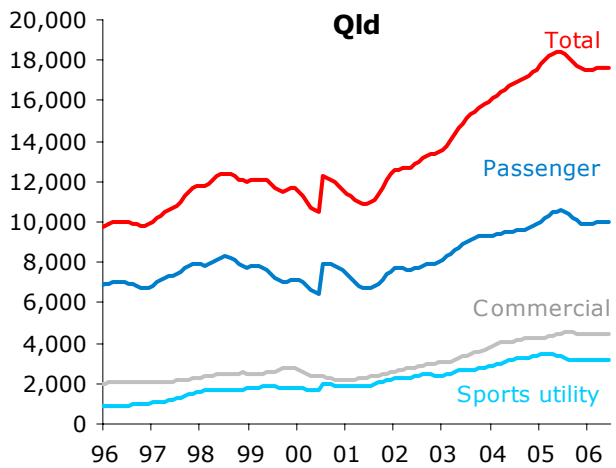
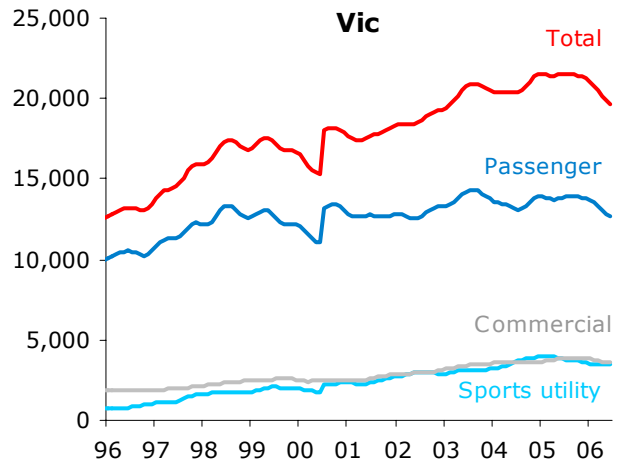
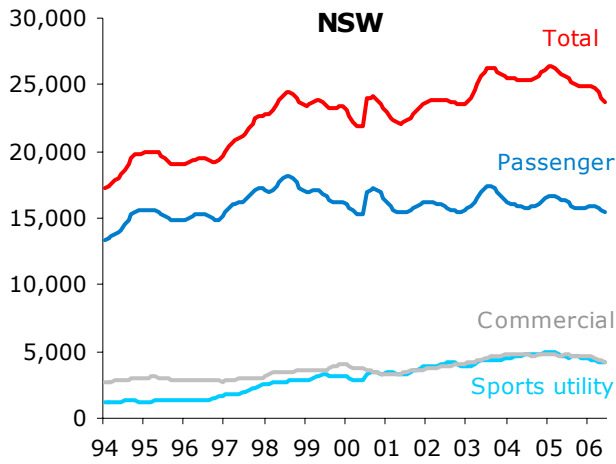
Source: Economics@ANZ.

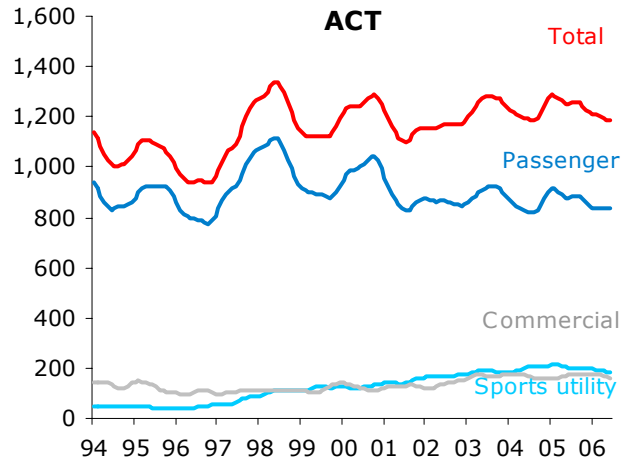
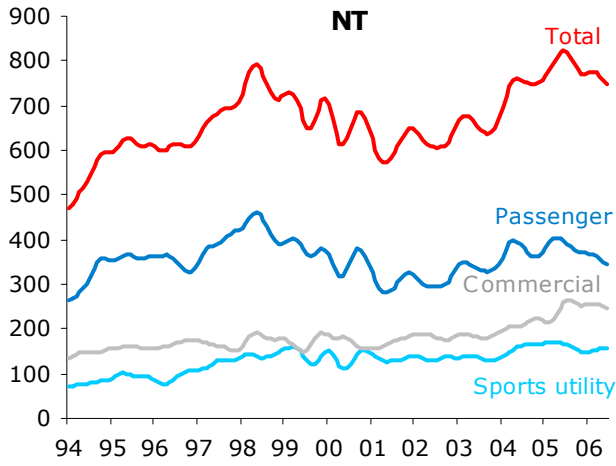
### Price outlook

The price of new passenger cars has been falling in Australia since late 2002. However, prices for all the other costs of running a private car have been increasing. Fuel prices in particular have risen dramatically over the last two years. Fuel prices are expected to remain high into the foreseeable future, due to unrelenting global demand pressures on petroleum. The price of car repairs, accessories and other car costs have been moving up too, albeit more slowly. The total cost of running a private car is therefore trending up, despite decent falls in the price of the car itself.

Close to 80% of new vehicles are imported, so Australia's exchange rate has a direct effect on new car prices. This has worked to the benefit of car buyers in recent years (see figure 14). With many key commodity prices now peaking, we are expecting Australia's exchange rate (against the US\$) to fall in early 2007. This will mean price rises in Australian dollars for new imported cars, as for all other imported goods. This will moderate in 2008, which should see import prices fall again. Other factors that can be expected to push up new car prices in 2007 include high global prices for steel and other key automotive manufacturing inputs. On the other hand, competition in the global auto industry remains keen and new low-cost manufacturers are emerging in China and elsewhere. These international competitive pressures should help to keep any price rises for new cars to a minimum.

## Appendix: new motor vehicle sales trends, by state and territory (sales per month, trend)





Source: ABS 9314.0.

### Data sources

- Australian Automotive Intelligence (AAI)
- Australian Bureau of Statistics (ABS)
- Federal Chamber of Automotive Industries (FCAI)
- Federation of Automotive Products Manufacturers (FAPM)
- Ford
- GoAuto New Car Diary
- Holden
- Snapdata International Group
- Toyota
- VFACTS



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